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Mr. William Frenzel
The President's Advisory Panel
on Federal Tax Reform
1440 New York Avenue NW
Suite 2100
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PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM
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Dear Bill:

Good luck in your tax reform efforts. I have been following the work of the commission and congratulate you on your efforts to date.

I hope that the commission will emphasize the importance of simplicity and transparency. Every tax debate brings forth many who are passionate supporters of equity and many others who are passionate supporters of efficiency. Unfortunately the supporters of simplicity are often ignored when the final decisions are made. The fact is that no tax system will ultimately be perceived as equitable or efficient unless it is simple and transparent. I hope that in its report the commission will give primary emphasis to the need for simplification and transparency.

Enclosed is a brief memo that discusses ways and means to avoid complexity.

All the best,


James Q. Riordan

JQR/slw

(Submission by: Individual)

P.S. If you'd like more specific
examples I'd be glad to
send them along.
JQR

To: William Frenzel

From: James Q. Riordan

3/23/05

The federal income tax system is in trouble. It needs to be simplified.

The income tax law is too complicated; it has too many special rules; it has lost the focus on its core objective, which is to raise the revenues needed to balance the budget over an economic cycle. It is being unwisely used to attempt to accomplish economic and social engineering objectives that are better left to the appropriation process. The tax law no longer enjoys the respect, support and voluntary compliance of the public. The process by which the Congress and the President have made the tax law increasingly complicated is viewed by the public with great cynicism.

The IRS is not able to administer the constantly changing, complicated law in an efficient manner. The IRS has not been given the resources it needs to accomplish its core mission and also discharge the diverse non-core responsibilities that have been thrust upon it. The IRS would be better able to do a good job and enjoy the support and respect of the public if the law were simpler and more stable and if it were relieved of its non-core responsibilities.

We all agree that the tax system should be as efficient and fair as possible, but it must be simple and transparent to function as a voluntary assessment system in a democracy. If the system is complicated and opaque, it is not likely in fact to be efficient or fair, and it will surely not be perceived as being efficient or fair. It will not enjoy public support and voluntary compliance.

The primary goal of tax reform should be to make the tax law simpler and more transparent. To accomplish this, the focus of the law should be returned to its core

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mission of raising the needed revenues. The tax law should not be used for financial and social engineering. Such engineering initiatives should be handled through the appropriation process. They should be administered by agencies other than the IRS. The desired level of progressivity should be achieved through the rate structure, not by byzantine special definitions of the tax base.

An income tax has two components: (1) a tax base, and (2) a rate structure.

The tax base should be premised on sound and simple general principles that apply to everyone, not complicated special rules. The complexity in the income tax law has been caused both by those who seek to make the law more "efficient" (i.e., more congenial to certain kinds of economic growth) and those who seek to make it more "fair" (i.e., more progressive). The complexity arises primarily from special provisions that manipulate the tax base by defining income; exemptions; credits and deductions in different ways for different taxpayers. The tax base should be defined in the same way for all taxpayers. The tax base should impose similar burdens on taxpayers with similar income (horizontal equity). Double taxation and biases against savings and investment should be eliminated from the tax base. The annual tax burden of those who save should not be greater than the annual burden of those with the same income who choose not to save. Our low national saving rate is a cloud on our future well-being. When the tax base is cleansed of its bias against savings, the rate structure should be set to raise the revenues required.

If Congress believes that efficiency requires that certain investments should be given special incentives (even if the tax law is purged of its biases against savings and

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investment) then such extra incentives as may be thought to be necessary to encourage such investments should be handled through the appropriation process and subject to periodic budget reviews.

Much of the recent complexity in the income tax law arises from the desire to make the tax law "fairer;" i.e., more progressive than it would be if there were simply a straightforward application of the rate structure on a tax base that was defined the same for everyone. Congress has increasingly granted and then withdrawn credits, exemptions, and deductions. This approach obfuscates the real progressivity of the rate structure and distorts the calculation of marginal rates. It is a deliberate substitute of opacity for transparency and complexity for simplicity. Taxpayers don't trust a tax system that resorts to what appears to be trickiness; and they don't respect a process that generates it. A voluntary assessment system requires trust and respect. Whatever progressivity is desired should be accomplished through a generally applicable tax base and an honest rate structure – not through special manipulations of the tax base that result in a misleading nominal rate structure.

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